
Kroger
Cut
GREEN BEANS
Kroger
NEW IMPROVED
smooth
Kid's love it

## Contents


THE KROGER CO. is a food and drug retailer and a food manufacturer, and through joint ventures, owns and operates theme amusement parks. Headquarters are in Cincinnati, Ohio, where Kroger was founded in 1883.

## Financial Highlights

| | 1978 | 1977* | Change |
|---|---|---|---|
| Sales | $ 7,828,071,073 | $ 6,747,552,890 | +16.0% |
| Net Earnings | $ 84,596,086 | $ 60,022,740 | +40.9% |
| Dividends Paid | $ 24,217,754 | $ 20,550,673 | +17.8% |
| Shareowners' Equity | $ 554,507,066 | $ 489,972,393 | +13.2% |
| Per Common Share | | | |
| Net Earnings | $ 6.22 | $ 4.44 | +$1.78 |
| Dividends | $ 1.78 | $ 1.52 | +$0.26 |
| Shareowners' Equity | $40.68 | $36.13 | +$4.55 |

*Restated to reflect the change made in 1978 in accounting for leases.

The year of 1978 was one of significant progress for The Kroger Co. A strong sales increase — considerably ahead of inflation — helped us achieve record earnings. Sales of $7.828 billion for 1978 increased 16% from 1977. Earnings of $84.6 million were $24.6 million ahead of 1977. Earnings per share were up 40% to $6.22

In keeping with our intent to reward our shareowners and maintain our record of dividend growth, the quarterly dividend rate was increased 45% in the past year — rising from 40¢ to 44¢ a share in June, to 50¢ in December and to 58¢ in March of 1979. These dividend increases indicate both our improved results and our confidence in the future performance of the Company.

At their January meeting, the Board of Directors proposed a two-for-one split of outstanding common shares. Shareowners will vote on the Board's recommendation at the Annual Meeting on April 12.

**1978 — Year of Achievement . . .**

improved performance throughout the Company — in both the food business and the drug store business — contributed to 1978's overall performance.

Kroger results reflect steps taken, beginning in the early 1970s, to rebuild and remerchandise the Company's food stores. Consumers have responded enthusiastically to those new stores and to our merchandising changes. In the last quarter of 1978, average weekly sales per food store were $124,900, up 18.4% compared to 1977.

These stores and the merchandising programs they make possible have brought about a positive change in the mix of products sold. We are committed to giving shoppers competitive prices on all products sold in our stores. However, such products as non-food merchandise, perishables, specialty items and Kroger manufactured products provide better-than-average gross profit. Our superstores enable us to sell proportionately more of these higher-margin items — and this enriched mix of products sold produces more profit on the same dollar sales total, while at the same time helping to hold down prices on the staple food items so important to the consumer's food budget. This is a key aspect of 1978's food store results.

This pricing and merchandising strategy is paying off for Kroger and it is beneficial to consumers.

Capital expenditures in 1978 totaled $114.5 million, and were primarily generated internally. In 1978, 104 new food stores were opened and 58 stores were remodeled. The continuing store modernization program is now resulting in significant net gains in store square footage. At the end of 1978, we were operating 30,673,000 square feet of retail food store space, a net increase of two million square feet from year-end 1977.

The opening of 3.3 million square feet in 1978 was a record in new food store square footage and gives support to our ongoing effort to expand our sales through modern facilities designed to serve consumers better. In addition to our sales potential from new square footage, we must continue to increase sales in existing stores as they mature — and to improve the quality of those sales.

**Looking to 1979 . . .**

Our store modernization program will continue in 1979, with plans for 100 new food stores and 70 remodeled stores. At the end of 1979, we should have 33 million square feet of food store space — a net increase of 2.3 million square feet from year-end 1978.

Capital expenditures in 1979 will be approximately $155 million. While the store program will continue to receive the most significant amount of our capital dollars, manufacturing will utilize a larger-than-normal portion of our 1979 capital expenditures for expansion of facilities to keep pace with the growing sales of Kroger products and to allow further merchandising opportunities.

Another important capital allocation will be spent for new technology designed to improve customer service and management efficiency. The installation of electronic scanner checkout systems will help us serve customers better, aid front-end efficiency and provide management with better information about product movement.

Many of the 1979 food store remodels represent enlargement or modernization of original superstores. These stores are capable of achieving greater sales and profits with expanded or new specialty departments — larger delicatessens, in-store bakeries and restaurants, floral shops, cheese shops — all adding to the attractiveness of the stores and generating larger average per-customer sales.

Our goals for 1979 reflect the necessity to improve gross margins by expanding the sales of higher profit perishables and general merchandise. Strong, continued sales growth is absolutely essential to cover the ever-increasing cost of operations — whether it be Social Security taxes (which will increase by an estimated $14 million in 1979) or the cost of utilities (which went up 17% between 1977 and 1978).

In recent years, SupeRx Drug Stores has slowed its store building program while concentrating on management effectiveness and remerchandising throughout the company. In 1979, SupeRx will move ahead with a more aggressive store building program with plans for 45 new stores. This compares to seven new stores in 1978 and 11 in 1977.

An important element in any business — *but critically essential in ours* — is providing courteous, friendly, helpful service to customers. Shoppers expect and deserve this type of treatment. We want customers to know that their purchases at Kroger are essential to our success. We are committed to doing a better job of improving, by our actions, Kroger's reputation for friendly service.

While many of our goals were attained in 1978, we have set higher expectations for 1979. The more than three-quarter-billion-dollar investment which we will have made in our business since the beginning of our major store building program in 1972 through 1979 demands the achievement of even better results. We believe we have the facilities, the merchandising programs and the people to bring about continued improvement in earnings.

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James P. Herring announced in late 1978 his retirement in early 1979 as Chairman of the Board of Directors. P's many contributions to The Kroger Co. will be of lasting benefit. During his leadership as Chief Executive Officer, President and Chairman, Kroger undertook the massive storing program which is showing such excellent results today. His leadership in planning, market and consumer research and the implementation of a team philosophy of management has contributed to strengthening the company to meet the new challenges that lie ahead. Mr. Herring will continue to serve your Company as a member of the Board of Directors.

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The Kroger Co. is dedicated to being a total merchant. We are the shopper for the shopper and must track carefully with changing consumer needs and react positively to consumer expectations for their food or drug shopping.

We must also meet our commitment to our employees to provide meaningful work that gives a sense of accomplishment and self-worth.

We have an obligation to communities where we operate. No business can ultimately prosper and be accepted unless it gives back to the community a portion of its resources to insure a healthy economic and social environment.

While there are some uncertainties with respect to the country's economic outlook, we believe Kroger has a broad range of options — with the type of facilities we have today — to merchandise and operate successfully within varying economic conditions.

We are committed to a continuance and improvement of our past programs while keeping abreast of change. The 107,092 employees who are Kroger intend to build upon our strong foundation to make 1979 another meaningful year for The Kroger Co., its employees, our customers, and for you, our shareowners.

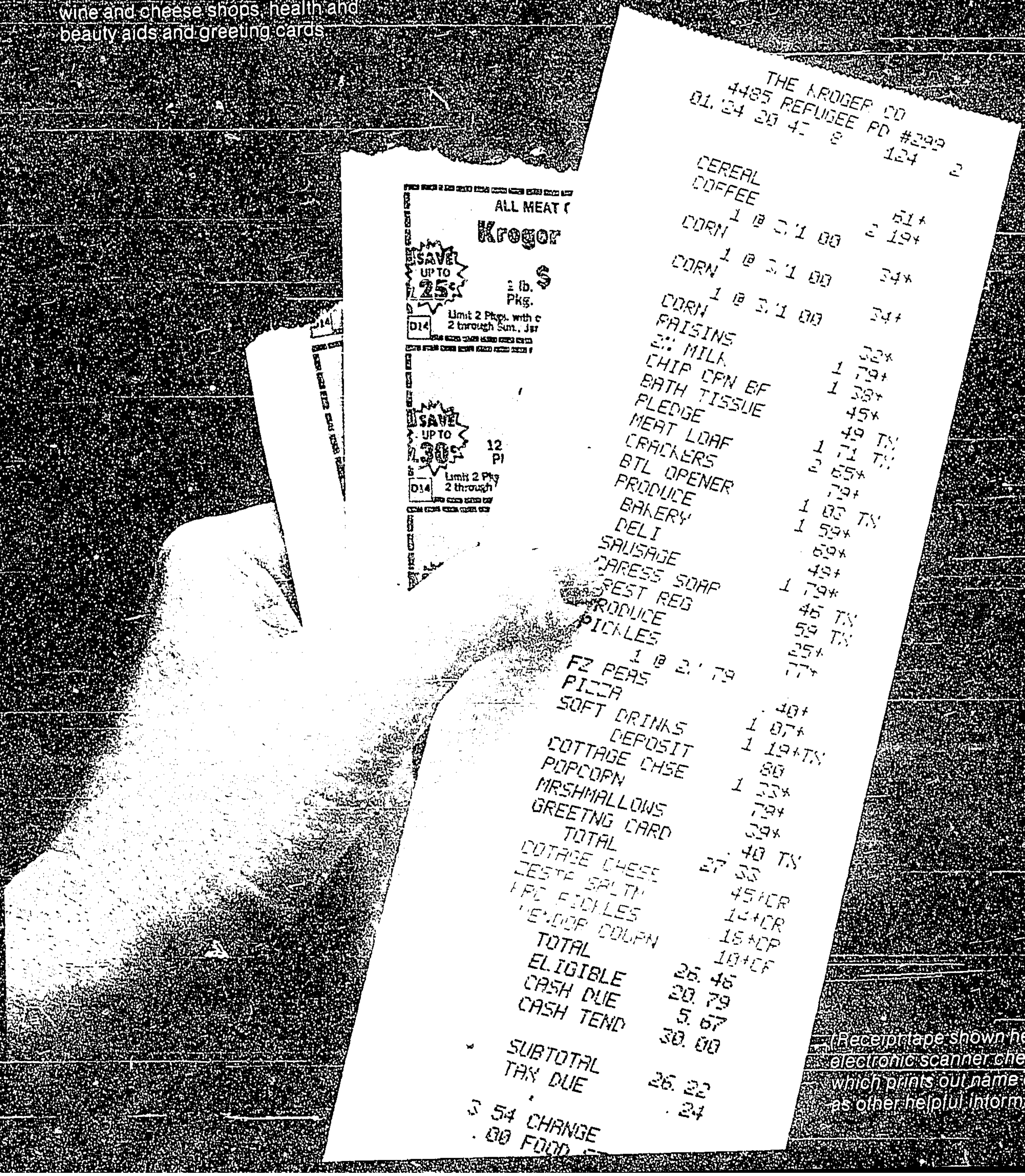
Sincerely,

President and
Chairman of the Board

March 5, 1979

## Kroger Food Stores

The Company's largest operation is Kroger Food Stores, with 1202 food stores in 21 states at the end of 1978. More than 80% of retail food store space is new or remodeled during the 1972-78 period. Most of these improved facilities are in the 25,000 to 45,000 square foot superstore category and offer specialty and personal-service departments such as delicatessens, in-store bakeries, wine and cheese shops, health and beauty aids and greeting cards.




(Receipt tape shown here is from new electronic scanner checkout system which prints out name of item as well as other helpful information.)

# A Discussion of the Business By Kroger Management . . .

*The following questions and answers summarize some of the areas of special interest to Kroger shareowners.*

**Kroger has had twelve consecutive quarters of increased sales and earnings compared to the prior year. What has brought this strong and steady improvement to Kroger?**

Kroger results today come from the successful implementation of our store modernization and merchandising plans — a program which began in 1972.

The key element to bring store and merchandising programs together successfully was *planning*. We developed the best merchandising programs possible, yet they would not have been successful had we not planned for the proper facilities to present them — and these facilities and merchandising concepts could not have been effectively utilized had we not planned for the training of our people. Talented, well-trained and motivated people to operate the stores and execute the programs made it all come together to produce desired results.

Planning gave us the ability to allocate our resources realistically and to direct our efforts — based on an objective evaluation of what we were, what we were capable of doing and where we believed we should be concentrating our efforts. We built strongly and carefully on a solid base, and that is why we have been seeing improvement on a steady and sustained basis.

**The major part of Kroger's capital expenditures for the past several years has been for food store modernization. Would you recap what has been accomplished — and is this program now completed?**

More than 80% of Kroger's retail food store square footage is new or remodeled since the beginning of 1972. To accomplish this, our capital expenditures have totaled $607 million, with about 70% going directly into store improvements.

From 1972 through 1978:

- *We have opened 586 new food stores and have remodeled 374 (often with substantial enlargements).*
- *We closed 813 older or unprofitable stores.*
- *Our food store retail square footage has increased approximately five million square feet, from 25.4 million to 30.7 million.*

Store modernization is a continuing program. We expect to open 100 new stores in 1979 and we plan at least this many stores in each of the next few years as part of our continuing store building program.

We are only starting to add to some of the earliest superstores new departments which have proven so popular in our newer superstores, such as cheese shops or bakery operations with breads and pastries baked in the store. We intend to stay modern and in tune with shoppers' preferences.

**How do you plan to finance your continuing store modernization program?**

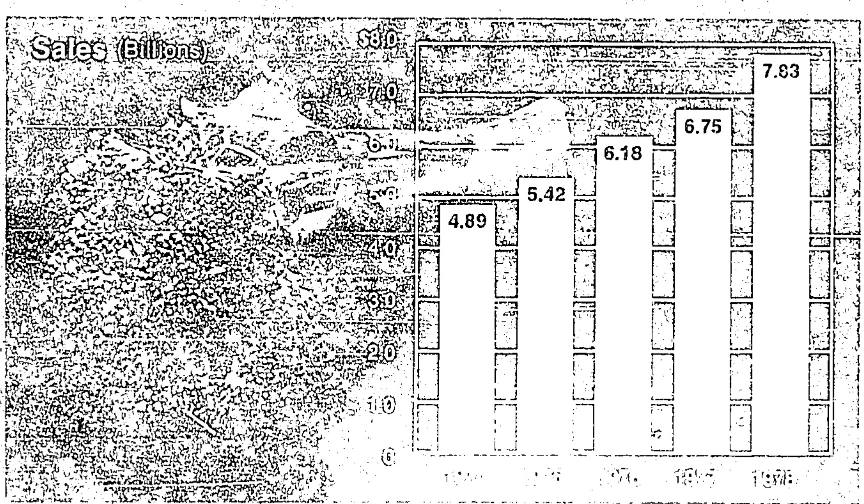
Kroger today is financially strong. At the end of 1978, we had $105 million of short-term investments which, together with what we can generate internally, places us in a healthy position to finance our capital program without additional major long-term financing in the immediate future.

During our period of rapid expansion and modernization, we have used what might be termed anticipatory financing. Our public borrowings have anticipated our needs as much as two years ahead — so that we could continue our program on a planned basis rather than perhaps significantly slowing our program in periods of tight money markets.

An additional advantage has been the fact that in a period of rising interest rates, financing has been obtained at a lower cost.

**What is Kroger's dividend policy?**

In considering dividend actions, the Board of Directors places the primary emphasis on creating the best balance of benefits for the shareowners over the long run . . .



with consideration to such factors as level and trend of profitability and opportunities for capital expansion.

Although no fixed percentage has been formally established for dividend payments, we would expect dividend payments to be approximately in the range of one-third to one-half of annual earnings as they have been for the past five years.

A dividend increase is a very tangible indication that management and the Board of Directors are convinced that we are progressing according to plan.

During the past year, the Company's excellent results and the favorable trends that have developed were recognized with three increases in the common dividend — a 45% increase from 40¢ per share per quarter to 58¢. The present rate of $2.32 per share annually represents about 37% of 1978 earnings.

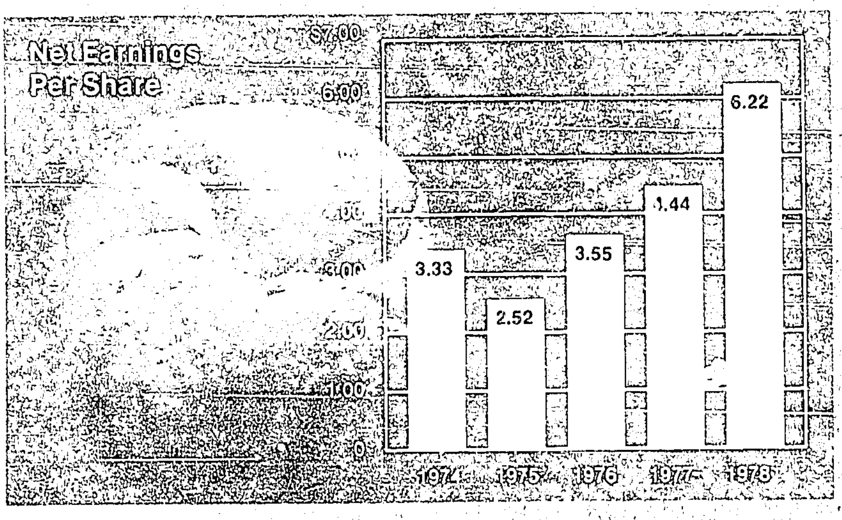
**One of the factors that has been identified as bringing higher sales to Kroger is the increased square footage. What kind of influence will this have in coming years?**

The additional food store retail square footage resulting from our store building program will have a growing influence in coming years (although our sales increases have far outpaced our increased square footage). At the beginning of 1972, our food store square footage was 25.7 million square feet. This stayed flat and even declined as we closed significant numbers of older stores during the early stages of our program.

However, as our store building program continued, square footage had grown to 30.7 million square feet by the end of 1978 . . . up 3.8 million in the past two years. By year-end 1983, as our present plans stand, we will be operating 13 million additional square feet of food store space. At the same time, we plan to work toward increased sales per square foot and more effective store operation to produce a more profitable mix of products sold.

The superstore remains the store which fills the shopping needs of the greatest number of our customers — but we are experimenting to find out whether there is a market for specialized types of shopping in a certain segment of the population.

It is too early to draw any firm conclusions as yet, although results to date have been encouraging. We do plan to experiment further in other markets in the coming year.




**What about limited-item or warehouse-type stores?**

We believe it is important to keep abreast of marketing developments in the supermarket industry. To date, we have opened 15 Bi-Lo limited-item stores in the Cleveland area. These average 10,000 square feet in size, carry about 450 fast-moving grocery items (nothing requiring refrigeration) which are stacked in cases on pallets. Shoppers sack their own groceries (and bring their own bags).

Barney's Food Warehouse is a membership store ($1 per month) carrying perishables, but a smaller assortment than a regular superstore (about 2500 items). Once again, shoppers perform many services for themselves. (A second Barney's is larger — 75,000 vs. 36,000 square feet — and offers an expanded variety of non-foods, including cosmetics and pharmacy.)

Both limited-item and warehouse stores pass the savings on to customers in the form of lower prices.

**SupeRx drug stores in 1978 achieved record earnings. How did SupeRx management accomplish this turnaround and most importantly, how will earnings be sustained?**

SupeRx' improvement has not come from any single factor, but rather from tightened operations and more effective merchandising throughout the company. Improvement is being implemented on a planned basis, with emphasis on key areas of the business — *pharmacy . . . merchandising*, particularly in the upgrading of higher-profit volume departments such as cosmetics . . . introduction of *new product lines*, such as prescription optical centers (there are now 14 such centers, with

30 additional planned for 1979), and emphasis on development of SupeRx men and women.

During the past couple of years, SupeRx has concentrated on evaluation and planning — identifying unprofitable or less productive stores, and preparing to replace them with new stores with more potential, as well as improving the performance of good existing stores. During this period — while we surveyed and planned — the SupeRx store building program was slowed down. Seven new stores were opened in 1978 and 48 were closed or sold.

Now SupeRx is gearing up for growth. Building plans for 1979 call for 45 new drug stores to be opened.

Drug stores represent a growth industry. SupeRx has made much progress during the past two years. This important part of our business is expected to continue to improve operations, merchandising and its contribution to total company profits in the coming year.

**SupeRx is building its first distribution center in Florida. How will that improve operations?**

A pilot distribution center serving SupeRx' Florida division is targeted for a spring, 1979, start-up date. While there will be an initial cost, it is expected in the future to impact favorably on SupeRx earnings through such factors as lower product and freight costs, lower inventories and other operating advantages.

In its early years, the no-warehouse, direct-buy system worked well for SupeRx. Now, changes in distribution patterns and economics indicate significant savings are available through warehousing — as well as a decided advantage to the marketing-operating team in implementing and maintaining higher merchandising, in-stock and pricing standards.

*(To cite just one example, manufacturers today will often ship only in case lots and require extensive lead time on orders . . . while a store might only need a few packages at a time. The warehouse operation will enable SupeRx stores to reduce inventory requirements at store level — and yet give stores the capability to get quick replenishment as needed.)*

Although plans for further warehousing have not yet been firmed up, it is expected that warehousing will eventually become a productive part of SupeRx' operation.

**Kroger has two new plants which moved into full production during 1978. How are the Newark, Ohio, dairy and the Georgia peanut butter plant doing?**

Steadily-increasing sales of Kroger's own brand products have increased the need for expansion of production capability. One of the fastest-growing and most popular lines with Kroger shoppers is dairy foods. We believe a good deal of credit for this strong consumer response has been the emphasis on high quality . . . a good deal of it made possible by the efficiency and cleanliness of our dairy plants, which are among the most modern in the United States.

The Newark, Ohio, dairy, which processes cartoned orange juice as well as fluid and cultured milk products, has far exceeded expectations.

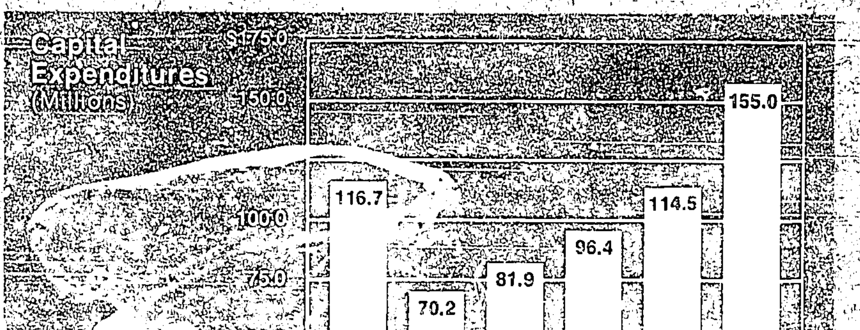
The Georgia peanut butter plant has more than doubled our capacity to produce peanut butter. This modern plant allows us to attain Kroger's high quality standards more efficiently . . . achieving improved flavor characteristics and controlled quality to a higher degree than ever before.

**What are your expansion plans for manufacturing in 1979?**

In 1979, several major projects will add production capacity and insure our ability to provide the good value that shoppers have come to expect from products packed under the Kroger label. Capital expenditures in the manufacturing area are estimated at $30 million in 1979.

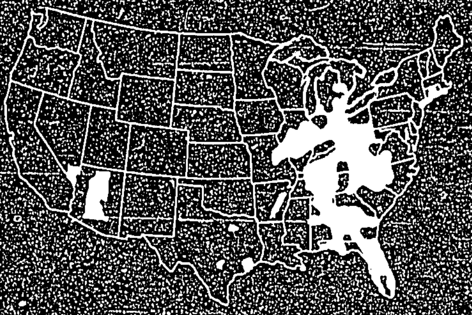
These include:

— Completion of the addition to the Minnesota cheese plant will add warehousing space and an individually-wrapped slice cheese line, in response to growing consumer demand for this product. The cheese plant addition is scheduled for completion in the fall of 1979.



# SupeRx Drug Stores

SupeRx Drug Stores, with 487 drug stores in 22 states at the end of 1978, is one of the country's largest drug store chains. Although SupeRx operates a majority of its drug stores in states where Kroger Food Stores are located, drug stores are also located in Arizona, Connecticut, Florida, New Jersey, New York and Nevada.



— The Columbus, Ohio, bakery will be expanded and add an additional bread and bun line.

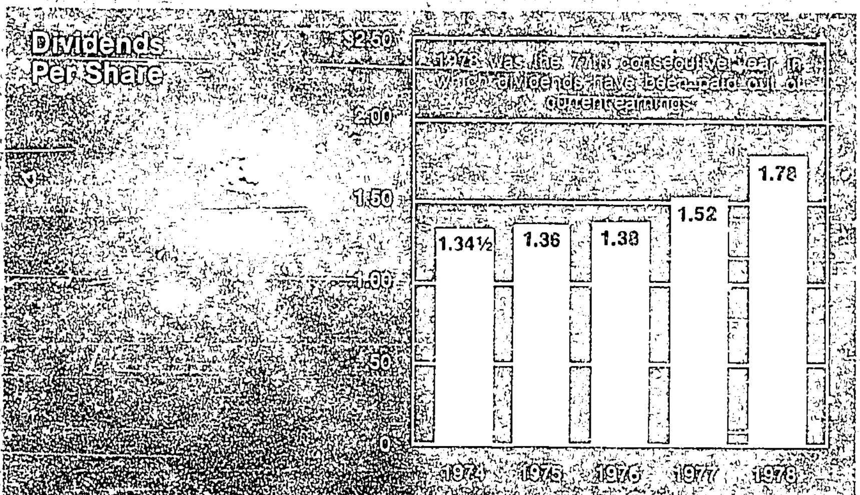
— The delicatessen kitchen will expand to allow for doubled production of dessert and salad items and to quadruple cooler capacity, allowing closer quality control of products to be distributed through this facility to store delicatessens.

The manufacturing division continues to look for opportunities to serve shoppers better and to maximize utilization of existing facilities. For example, one of the most popular new product lines is our sauce and gravy mixes. The same type of equipment which has been used for gelatin and powdered drink mixes through the years can be used for other dry mixes, such as sauce and gravy or dry salad dressing mixes.

**How are the Kroger Sav-On stores doing?**

We now operate 32 Kroger Sav-On combination food, drug and general merchandise stores, in addition to the smaller 21 Kroger Family Center stores which are operated in Texas and Louisiana. In 1979, we plan to open seven Kroger Sav-On stores.

We are increasingly convinced of the viability of this concept and its potential for profitable sales. The combination store contains the elements that will help us serve shoppers better and allow us to be efficient — while enriching the mix of products sold by expanding the assortment offered . . . particularly in higher-profit non-food merchandise.




This kind of store (averaging about 55,000 square feet in size) has greater than average opening costs and takes longer to reach maturity. In those stores located in established Kroger marketing areas, the experience of our people and the general acceptance of Kroger has helped to build sales more rapidly and stores are moving to profitability more quickly than in the new Carolinas marketing area, where Kroger is a "new face in town," and where we have limited representation. We are making satisfactory progress, however, and are totally convinced that the Carolinas offer us great opportunities for sales and profit, and have made a commitment to expand our facilities in this important market.

**A number of supermarket companies have begun carrying so-called generic or no-name brand products which have plain labels and sell for a cheap price. What is Kroger doing in this area?**

We are giving customers the *same lower prices with known Kroger brands, consistent supply, guaranteed quality, and a full assortment of products and sizes.* Since Kroger shoppers can get the price advantage of no-name products along with the benefits of Kroger brand products, we have no present plans to market this type product.

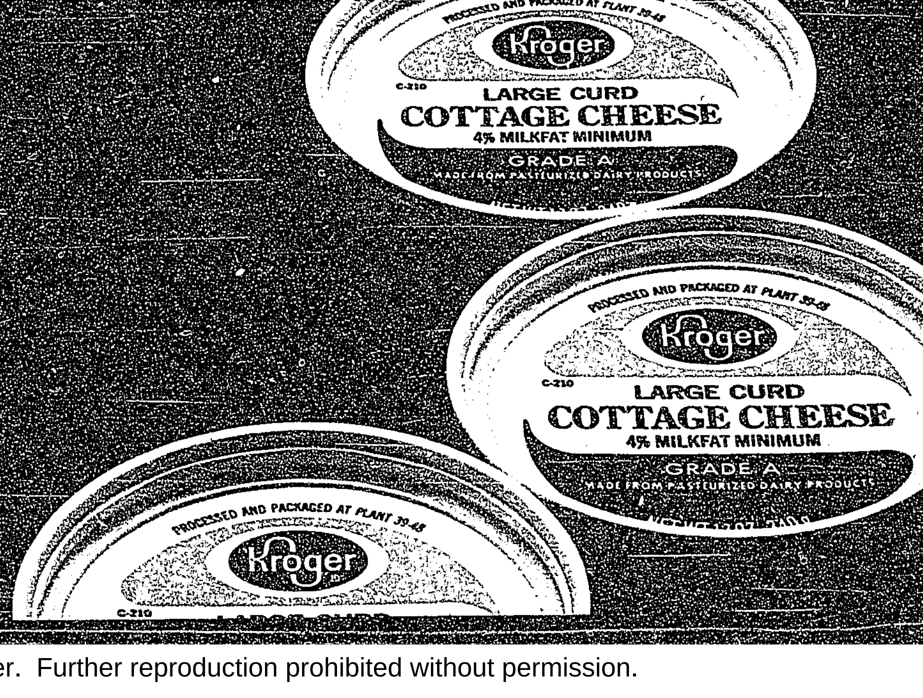
Much has been made of the plain label, but it costs just about the same as a regular label — and could even cost more for a smaller printing run. (A label costs less than one-half cent per can.) As most companies offering these products have pointed out, the major savings comes from the fact that they are buying lower-grade products (e.g., Standard grade versus Choice or Fancy for the national brand products to which they are compared). There's nothing wrong nutritionally with the food, but shoppers should know what they're buying . . . a good rule for *all* food shopping.

**Kroger plans to build a total of 100 new food stores next year. How do you decide that a particular location will meet your objectives for a store?**

We look at the total demographics of an area — not just population. Obviously, the number of potential customers is an important factor, but we also want to know the location's accessibility, residents' income level, family size and how much they might be expected to spend in a supermarket today as well as the growth outlook for the total area.

Using all the information, we can determine the potential sales level for that location. We have further flexibility in that we can build the size superstore which fits the needs of the market and which will produce a profitable level of sales. A 27,000

## Manufacturing Facilities

Kroger manufactures and processes a number of products for sale in its stores, a tradition which began before the turn of the century. The Company operates seven bakeries and six dairies in addition to a sausage plant, a cheese plant, egg production facilities, egg grading and packing plants, a peanut butter plant, a candy plant, a delicatessen kitchen, a pharmaceutical plant and a general processing plant where such products as coffee, tea, preserves, salad dressings, spices, nuts and other items are processed. Other private label products are prepared for sale in Kroger stores by leading food processors throughout the country.

square foot superstore might be the proper size for one market while another might have need for a 35,000 or a 45,000 square foot superstore.

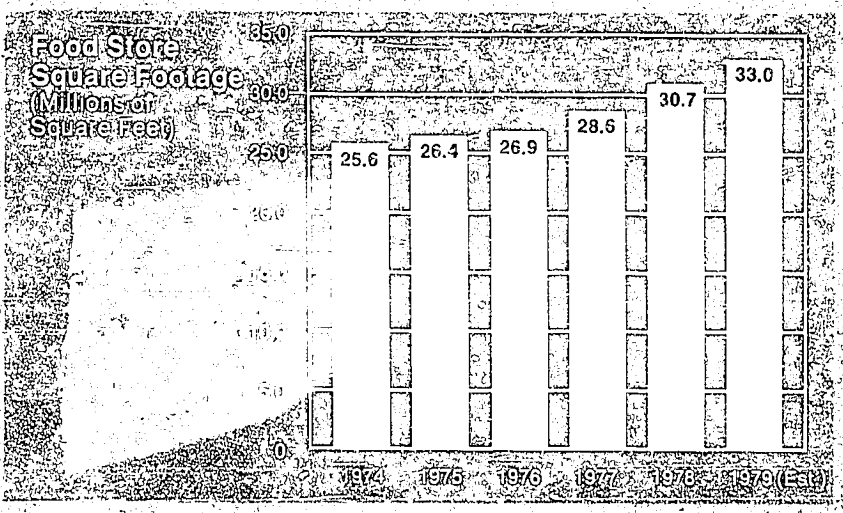
We believe that the choice of location and the type store which is to be built there is one of the key decisions that must be made in a store building program — and Kroger's approach to this decision today is armed with the most sophisticated planning and research in our history.

**To what extent is Kroger using electronic scanner checkout systems? What are your plans? With the cost of this equipment, how will it benefit the Company's profitability and the customer who wants lower prices?**

The scanner-type, electronic checkout system is probably the most important technological advance in the supermarket industry in the past 50 years. It benefits both the Company and the customer — making possible improved shopper service, more efficient store operation, and producing a flow of information which formerly could not be captured and processed for management's use. The marketing and operating data which will be generated by scanner systems can be an invaluable tool for the future. We are quite excited by the potential.

For the past four years, Kroger has been testing various systems in selected markets (there are now 11 scanner checkout systems in operation in Kroger stores). We believe that this system has proven its worth and demonstrated its capabilities — and during 1979, we will expand the systems to 50 or more stores — allowing the majority of our marketing areas to gain experience with the system. This program will be continued and expanded in the years to come.

Response from both customers and employees to the new system has been positive. Customers appreciate the faster and more accurate service, as well as the itemized receipt tape which shows the name of the product in addition to the price — providing a full record of purchases which can be [illegible] for such things as comparison of price from week to week, or among supermarkets.




We believe that scanner checkout systems such as this will become a definite competitive factor in the years to come. While the initial investment is high, our experience has indicated that the return on investment meets our criteria.

**Why did you sell Top Value?**

Even though the stamp company had been an autonomous operation, we found that Top Value's efforts to attract new business were inhibited by the merchandising decision of Kroger Food Stores to discontinue the use of stamps (*Kroger's last use of stamps was in 1976 and our merchandising plans do not contemplate the use of stamps*).

This, of course, limited Top Value's growth so long as it remained a Kroger subsidiary and impeded us from getting satisfactory results for our shareowners. Since the vitality of the trading stamp business could not be fully realized under these circumstances, the sale decision was made. (*See Financial Review section for further information.*)

**Late in 1978, businesses across the country were asked to comply voluntarily with President Carter's wage/price guidelines. Is Kroger cooperating and how will this affect the business in 1979?**

Yes, we have notified the Council on Wage and Price Stability that we will make a good-faith effort to comply voluntarily with the wage/price guidelines. The program's objectives of holding down prices as much as possible for consumers and of controlling operating expenses are consistent with our own objectives as a food merchant.

Our decision to comply voluntarily and our confidence that we can continue to progress does not mean that we are unaware of the difficulties or problems that might arise in the administration of the program. However, we believe that this voluntary program deserves a chance — and at the very least, it should serve to increase awareness on the part of all of us of the necessity to gain efficiencies in our business operation, and to try to hold down prices.

At the same time, the Government must work toward long-range solutions with sound fiscal and monetary policies.

# Discussion cont.

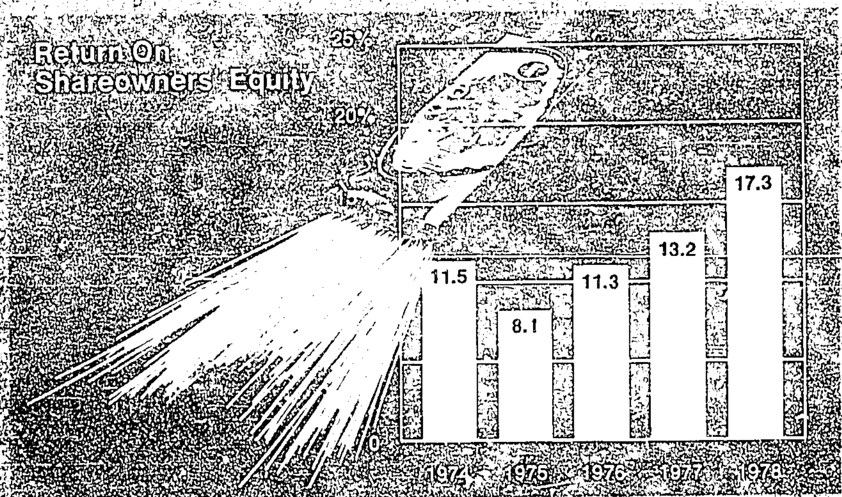
**Kroger today has what has been termed by many the most modern retail food company in the country — with many new facilities and revitalized merchandising programs contributing to its growth. You [illegible] retail square footage substantially in the years ahead. How will this impact on future sales and earnings?**

Although there has been an [illegible] of sales and earnings [illegible]. We do have a high degree of confidence that the large investment of time and money that has been made in modernizing facilities and bringing the new merchandising programs on-stream will produce further improvements in sales and earnings in each of the years ahead. The experience of recent years [illegible] us this confidence [illegible] look at what has been [illegible]

The Company's [illegible] [illegible] [illegible] [illegible]

It was also the period when large numbers of older smaller stores were closed and square footage stayed relatively flat. [illegible]

By the end of 1975, growing numbers of the stores opened in the early phases of the program were beginning to mature and to generate the earnings that had been planned and expected. Total square footage also began to increase, and the growth pace strongly accelerated in 1977 and 1978.




As these factors came together, return on shareowners' equity [illegible] increased to 11.3% in 1976, to 13.2% in 1977 and to 17.3% in 1978.

What has happened in the past three years in this important measurement factor clearly demonstrates what has been happening in The Kroger Co. and indicates the direction we intend to take. It reflects our determination to become a top performer in the retail food industry.

# Financial Report

Financial Review

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Five Year Summary

# Financial Review

**Management's Analysis of Summary of Operations**

Sales were $7,828,071,000 in 1978, up 16% or $1,080,518,000 from 1977. Food store sales increased 17.4%. Higher tonnage resulting from the 7.1% increase in food store square footage, increases in sales in existing stores and rising price levels accounted for the sales increase. Drug store sales declined slightly due primarily to the closing of 48 stores during the year.

Sales were $6,747,553,000 in 1977, an increase of 9.1% from 1976. However, 1976 included 53 weeks compared to 52 weeks in 1977. Removing the effect of the 53rd week in 1976, the sales increase in 1977 over 1976 was 11.1%. Food store sales increased 12.4% (after removing the effect of the 53rd week) due to an increase in the number of stores, increased sales in existing stores and increases in price levels. Drug store sales increased moderately even though there were 30 less stores in operation at year end.

Merchandise costs, including warehousing and transportation, were 77.7% of sales in 1978, 78.1% of sales in 1977 and 78.5% of sales in 1976. These reductions in rates are due to the continuing improvement in the margins of perishable departments and sales of products manufactured by the Company which typically carry higher than average margins. Rapidly escalating labor, payroll tax and utility costs are the major factors for the increases in operating, general and administrative expenses for the last two fiscal years.

Rent and depreciation for the past two years have increased because of the opening of larger food stores. Interest expense increased in 1977 because of additional long-term debt assumed late in 1976. A reduction of $18,931,000 in long-term debt resulted in a decrease in interest expense in 1978. Interest income increased in 1978 due to substantially higher rates available on money market instruments. Taxes based on income were 44.8% of earnings before taxes based on income in 1978 and 43.7% in 1977.

During the fourth quarter of 1978, Top Value Enterprises, Inc., a wholly-owned subsidiary, was sold which resulted in an after tax gain of $3,068,000 or 23¢ per share. The Company also realized an after tax loss on marketable investment securities of $2,936,000 or 22¢ per share, during the same quarter.

In 1978 the Company's net earnings were a record high of $84,596,000, an increase of $24,573,000 or 40.9% over 1977. Food store operating profits increased 34.5%. Operating profits of SupeRx Drug Stores improved 29.1% as they continued to respond to more effective merchandising programs and the closing of unprofitable and marginally profitable stores. In 1978 the Company adopted the provisions of SFAS No. 13 dealing with the accounting treatment for leased properties. Results for 1977 and prior years have been restated to reflect this change. There was no material impact on net earnings for any of the years.

In 1977 the Company's net earnings were $60,023,000, an increase of 25.2% over 1976. The return on the investment in larger more efficient food stores began to flow through to net earnings. Operating profits of SupeRx Drug Stores improved $3,300,000 from the depressed 1976 earnings as they began to respond to newly initiated merchandising and operating programs.

This analysis of the Company's operations for the years 1976, 1977 and 1978 should be read in connection with the Consolidated Statement of Earnings (Page 16), Operating Results by Segments of Business (Page 15) and the Five Year Summary (Page 24).

**Capital Expenditures**

Capital expenditures for 1978 totaled $114,504,000, up from $96,417,000 in 1977. Expenditures in 1978 included $68,624,000 or 59.9% of the total for retail stores and related equipment; $22,684,000 for food processing facilities and equipment, and $17,788,000 for vehicles and distribution center facilities and equipment. Investment tax credits were 71¢ per share in 1978 compared to 61¢ per share in 1977. Capital expenditures for 1979 are projected to be $155,000,000, the major portion of which will be spent on retail stores and related equipment. No major financings are planned for 1979.

**Dividends**

Dividends of $1.78 per share were paid in 1978 which marks the 77th consecutive year in which dividends have been paid out of current earnings. The quarterly dividend was increased three times during 1977 and 1978 — from 36¢ per share to 40¢ in the third quarter of 1977, to 44¢ in the second quarter of 1978 and to 50¢ per share in the fourth quarter of 1978. On January 19, 1979 the Board of Directors again increased the regular quarterly dividend to 58¢ per share payable March 1, 1979 to owners of record February 2, 1979.

**Quarterly Results**

Sales for the fourth quarter of 1978 were $1,995,704,222, an increase of 18.4% over the fourth quarter of 1977. Earnings of $30,095,532 or $2.21 per share increased 60.1% from $1.38 per share earned in the fourth quarter 1977. Quarterly sales, merchandise costs (including warehousing and transportation), earnings, earnings per share and common stock price range for 1978 and 1977 were as follows

| | Sales In Millions | | Merchandise Costs In Millions | | Earnings In Millions* | | Earnings Per Share* | | Common Stock Price Range | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 1978 | 1977 | 1978 | 1977 | 1978 | 1977 | 1978 | 1977 | 1978 | 1977 |
| 1st (12 weeks) | $1,675 | $1,470 | $1,308 | $1,146 | $12.4 | $10.3 | $ .91 | $ .77 | 29¾ - 25¾ | 27½ - 23⅝ |
| 2nd (12 weeks) | 1,751 | 1,526 | 1,362 | 1,186 | 18.6 | 15.3 | 1.37 | 1.13 | 35¼ - 28⅝ | 26⅜ - 24¼ |
| 3rd (16 weeks) | 2,406 | 2,066 | 1,866 | 1,617 | 23.5 | 15.7 | 1.73 | 1.16 | 36¾ - 31⅛ | 28¾ - 25½ |
| 4th (12 weeks) | 1,996 | 1,686 | 1,548 | 1,321 | 30.1 | 18.7 | 2.21 | 1.38 | 37 - 31⅝ | 27¾ - 23¼ |
| | $7,828 | $6,748 | $6,084 | $5,270 | $84.6 | $60.0 | $6.22 | $4.44 | | |

*Restated to reflect the change made in 1978 in accounting for leases

## Segments of Business

The Company's segments of business information for the years 1974 through 1978 were as follows:

| | 1978 | 1977 | 1976 | 1975 | 1974 |
|---|---|---|---|---|---|
| | | (in millions of dollars) | | | |
| Sales | | | | | |
| Food Business | $ 7,336 | $ 6,221 | $ 5,678 | $ 4,963 | $ 4,508 |
| Drug Stores | 532 | 527 | 505 | 458 | [illegible] |
| Total | $ 7,828 | $ 6,748 | $ 6,183 | $ 5,421 | $ 4,390 |
| Operating Profit | | | | | |
| Food Business | $ 169.9 | $ 125.9 | $ 100.0 | $ 85.7 | $ 98.9 |
| Drug Stores | 22.6 | 17.6 | 8.2 | 9.4 | 13.7 |
| | $ 191.5 | $ 143.1 | $ 1[illegible]4.2 | $ 95.1 | $ 112.[illegible] |
| Unallocated Expenses | | | | | |
| Corporate expenses, net | $ 8.2 | $ 5.8 | $ 1.3 | $ 8.8 | $ 7.1 |
| Interest expense | 30.0 | 30.6 | 27.7 | 25.4 | 23.4 |
| | $ 38.2 | $ 36.4 | $ 29.0 | $ 34.2 | $ 30.5 |
| Earnings before taxes based on income | $ 153.3 | $ 106.7 | $ 85.2 | $ 58.9 | $ 81.6 |
| Taxes based on income | 68.7 | 46.7 | 37.3 | 24.8 | 36.7 |
| Net earnings | $ [illegible] | $ [illegible] | $ 47.9 | $ 34.1 | $ [illegible] |
| Identifiable Assets | | | | | |
| Food Business | $1,284.9 | $1,133.4 | $1,082.1 | $ 993.6 | $ 993.9 |
| Drug Stores | 162.4 | 164.8 | 164.0 | 146.1 | 130.2 |
| Other unallocated | 205.7 | 230.5 | 193.6 | 152.3 | 142.5 |
| Total assets | $1,653.0 | $1,528.7 | $1,415.5 | $1,[illegible] | $1,[illegible] |
| Capital Expenditures | | | | | |
| Food Business | $ 103.8 | $ 90.9 | $ 78.3 | $ 55.0 | $ 55.9 |
| Drug Stores | $ 3.2 | $ 1.8 | $ 2.0 | $ [illegible] | $ 1.5 |
| Depreciation and Amortization | | | | | |
| Food Business | $ 60.6 | $ 56.7 | $ 53.2 | $ 51.7 | $ 47.4 |
| Drug Stores | $ 3.2 | $ 3.2 | $ 3.2 | $ 3.0 | $ 2.4 |

# Consolidated Statement of Earnings

| Years Ended December 30, 1978 and December 31, 1977 | 1978 (52 Weeks) | 1977 (52 Weeks) |
|---|---|---|
| Sales | $[illegible] | $5,747,[illegible],000 |
| Costs and expenses: | | |
| Merchandise costs, including warehousing and transportation | $6,[illegible] | $[illegible] |
| Operating, general and administrative expenses | 1,307,[illegible],372 | 1,[illegible]9,305,338 |
| Rent | 9[illegible],764,[illegible] | 80,369,[illegible] |
| Depreciation and amortization | [illegible] | [illegible] |
| Dividend and interest income | (12,[illegible]) | ([illegible]) |
| Interest expense on long-term debt | 2[illegible],[illegible] | 2[illegible],[illegible] |
| Other interest expense | 9,[illegible] | 9,005,[illegible] |
| Total | $7,[illegible] | $6,640,631,354 |
| Earnings before taxes based on income | $ 153,259,407 | $ 106,671,536 |
| Taxes based on income | 68,[illegible],321 | 46,648,796 |
| Net earnings | $ 84,598,086 | $ 60,022,740 |
| Average number of shares of common stock outstanding | [illegible] | 13,519,671 |
| Net earnings per share of common stock | $ 6.22 | $ 4.44 |

# Consolidated Statement of Accumulated Earnings

| Years Ended December 30, 1978 and December 31, 1977 | 1978 | 1977 |
|---|---|---|
| Accumulated earnings — Beginning of the year | $ [illegible],235,860 | $ 386,285,834 |
| Reduction of accumulated earnings relating to capitalization of leases | | (2,522,041) |
| As restated | $ [illegible],235,860 | $ 383,733,793 |
| Net earnings for the year | 84,598,086 | 60,022,740 |
| | $ 507,831,046 | $ 443,786,533 |
| Dividends on common stock — $1.78 per share in 1978 and $1.52 per share in 1977 | 24,217,754 | 20,550,673 |
| Accumulated earnings — End of the year | $ 483,614,192 | $ 423,235,860 |

[illegible]

# Consolidated Statement of Changes In Financial Position

| Years Ended December 30, 1978 and December 31, 1977 | 1978 (52 Weeks) | 1977* (52 Weeks) |
|---|---|---|
| **Sources of Working Capital** | | |
| From operations: | | |
| Net earnings | $ 84,556,086 | $ 60,022,740 |
| Charges (credits) to earnings not involving funds: | | |
| Depreciation and amortization | 65,179,454 | 61,393,663 |
| Provision for deferred federal income taxes | 9,739,000 | 9,333,000 |
| Gain on sale of subsidiary | (3,441,960) | |
| Loss on marketable investment securities | 4,046,960 | |
| Total from operations | $160,079,540 | $130,749,403 |
| Capital stock issued under option plans | 1,236,757 | 1,739,211 |
| Additions to obligations under capital leases | 11,801,074 | 4,257,897 |
| Reduction of marketable investment securities | 7,488,070 | 11,006,692 |
| Proceeds from sale of subsidiary | 10,000,000 | |
| Net book value of fixed asset disposals | 6,499,222 | 13,096,083 |
| Total sources | $197,104,663 | $160,849,286 |
| **Uses of Working Capital** | | |
| Cash dividends paid to shareowners | $ 24,217,754 | $ 20,550,673 |
| Capital expenditures | 114,603,511 | 96,416,593 |
| Increase in leased property under capital leases | 11,801,074 | 4,257,897 |
| Increase in investment in unconsolidated companies | 2,329,900 | 17,735,000 |
| Reduction of unredeemed trading stamps | 26,926,973 | 58,922 |
| Reduction of long-term debt and obligations under capital leases | 17,803,844 | 23,191,904 |
| Employees' benefit fund payments, net of provision | 3,145,168 | 2,172,146 |
| Purchase of capital stock for treasury | | 896,657 |
| Other changes, net | 1,167,077 | (60,156) |
| Total uses | $201,995,301 | $165,219,636 |
| Net decrease in working capital | $ (4,890,638) | $ (4,370,350) |

## Analysis of Working Capital Changes

| | Increase (Decrease) | |
|---|---|---|
| Current asset changes: | | |
| Cash and short-term investments | $ (2,236,903) | $(19,250,348) |
| Inventories | 73,682,168 | 65,298,323 |
| Other current assets | 9,873,504 | 10,133,148 |
| Net increase in current assets | $ 81,318,769 | $ 56,181,123 |
| Current liability changes: | | |
| Current portion of long-term debt | $ (3,775,154) | $ 412,889 |
| Accounts payable | 72,597,124 | 45,220,231 |
| Accrued expenses and taxes | 44,064,195 | 14,697,717 |
| Current portion of unredeemed trading stamps | (26,926,973) | (58,922) |
| Current portion of obligations under capital leases | 250,215 | 279,558 |
| Net increase in current liabilities | $ 86,209,407 | $ 60,551,473 |
| Net decrease in working capital | $ (4,890,638) | $ (4,370,350) |

*The accompanying notes are an integral part of the financial statements.*
**Restated to reflect the change made in 1978 in accounting for leases.*

# Consolidated Balance Sheet

| Assets | Dec. 30, 1978 | Dec. 31, 1977* |
|---|---|---|
| **Current Assets** | | |
| Cash | $ 28,467,058 | $ 16,547,030 |
| Short-term investments, which approximate market | 105,000,867 | 119,157,808 |
| Receivables | 78,170,579 | 68,925,759 |
| Inventories | 697,327,456 | 623,645,288 |
| Store and general supplies | 7,211,472 | 7,728,850 |
| Prepaid and other current assets | 27,711,028 | 26,564,966 |
| Total current assets | $ 943,888,470 | $ 862,569,701 |
| **Investments** | | |
| Marketable investment securities | $ 19,866,739 | $ 28,442,085 |
| Investments in and advances to unconsolidated companies | 45,285,017 | 42,744,623 |
| Other investments | 4,914,228 | 4,635,999 |
| Total investments | $ 70,066,984 | $ 75,822,707 |
| **Property, Plant and Equipment** | | |
| Land | $ 23,891,053 | $ 24,870,969 |
| Buildings | 126,864,587 | 118,302,333 |
| Equipment | 554,294,090 | 509,969,465 |
| Leaseholds and leasehold improvements | 183,534,784 | 166,939,019 |
| Leased property under capital leases | 133,274,463 | 121,473,409 |
| | $1,021,658,997 | $ 941,555,195 |
| Allowance for depreciation and amortization | 400,367,454 | 370,566,099 |
| Property, plant and equipment, net | $ 621,291,543 | $ 570,989,096 |
| **Other Assets** | | |
| Excess of cost of investments in consolidated subsidiaries over equities in net assets | $ 17,782,070 | $ 19,339,394 |
| **Total Assets** | $1,653,029,067 | $1,528,720,898 |

## Liabilities

| | Dec. 30, 1978 | Dec. 31, 1977* |
|---|---|---|
| **Current Liabilities** | | |
| Current portion of long-term debt | $ 3,852,000 | $ 7,627,154 |
| Accounts payable | 416,390,000 | 343,792,876 |
| Accrued expenses | 175,896,582 | 140,740,058 |
| Accrued federal income and other taxes | 55,952,352 | 37,844,862 |
| Current portion of unredeemed trading stamps | | 26,920,073 |
| Current portion of obligations under capital leases | 2,730,716 | 2,489,501 |
| Total current liabilities | $ 654,821,631 | $ 568,412,22[illegible] |
| **Other Liabilities** | | |
| Long-term debt | $ 233,756,000 | $ 238,892,29[illegible] |
| Unredeemed trading stamps | | 26,926,973 |
| Deferred federal income taxes | 80,214,000 | 76,505,000 |
| Employees' benefit fund | 28,789,251 | 31,934,419 |
| Obligations under capital leases | 105,137,119 | 96,077,598 |
| Total other liabilities | $ 443,900,370 | $ 470,336,281 |
| **Total Liabilities** | $1,098,522,001 | $1,038,748,505 |

## Shareowners' Equity

| | | |
|---|---|---|
| Common capital stock, par $1, at stated value | | |
| Authorized: 18,000,000 shares | | |
| Issued: 1978 — 13,921,053; 1977 — 13,852,126 | $ 91,897,801 | $ 90,661,044 |
| Accumulated earnings | 483,914,102 | 423,235,860 |
| | $ 575,811,903 | $ 513,896,904 |
| Common stock in treasury, at cost — 290,227 shares | 9,959,991 | 9,959,991 |
| Net unrealized loss on marketable equity securities | 11,348,836 | 14,286,120 |
| **Total Shareowners' Equity** | $ 554,507,966 | $ 489,672,893 |
| **Total Liabilities and Shareowners' Equity** | $1,653,029,967 | $1,528,420,898 |

*The accompanying notes are an integral part of the financial statements.*
**Restated to reflect the change made in 1978 in accounting for leases.*

## Accounting Policies

The following is a summary of the significant accounting policies followed in preparing the financial statements. These policies conform to generally accepted accounting principles, and have been consistently applied after restatement for the change in accounting for leases.

### Principles of Consolidation

The consolidated financial statements include the Company and all of its subsidiaries. Certain partially-owned affiliated companies are included in the financial statements on the equity basis

In 1978, the Company adopted the policy of including a previously unconsolidated company on a consolidated basis This company had previously been reported on the equity basis The change in consolidation policy had no effect on 1978 or previously reported net earnings and no significant effect on the overall financial statements Certain individual financial statement categories were restated for 1977 to give retroactive effect to this policy

### Inventories

The inventories are valued at the lower of cost or market with cost determined on the retail and first-in, first-out methods

### Marketable Investment Securities

Marketable investment securities consist of bonds, notes and common and preferred stocks held for investment. Dividend and interest income are accrued as earned. The cost of marketable investment securities sold is determined on the specific identification method.

Marketable equity securities (common and preferred stocks) are carried at the lower of cost or market. A valuation allowance, representing the excess of cost over market of these equity securities, is included in shareowners' equity Other marketable investment securities (bonds and notes) are carried at cost unless there is a permanent impairment of value at which time the securities are valued at market. In management's opinion there is no indication of a permanent loss in value in the non-current portion of the portfolio and there is no present intention to liquidate the non-current securities at less than cost.

### Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation and amortization, which include the amortization of assets recorded under capital leases, are computed principally on the straight-line basis All maintenance and repairs are charged to earnings. Betterments and renewals which increase the value or productive capacity of assets are capitalized

### Excess of Cost of Investments in Consolidated Subsidiaries Over Equities in Net Assets

The excess of cost of investments in consolidated subsidiaries over equities in net assets at dates of acquisition originating prior to November, 1970 is not being amortized because, in the opinion of management, there has been no decrease in value. Amounts arising after October, 1970 are not significant and are being amortized on the straight-line basis over forty years

### Deferred Federal Income Taxes and Investment Tax Credit

Deferred federal income taxes include the amount of tax applicable to the excess of depreciation for tax purposes over depreciation used for financial reporting purposes and the amount of tax applicable to the change in 1973 from the LIFO (last-in, first-out) to the FIFO (first-in, first-out) method of inventory valuation, less the amount of tax applicable to the excess pension expense (related to the unfunded pension liability) and, in 1977, costs of redemption included in the liability for unredeemed trading stamps which are not allowed for current tax purposes.

Investment tax credits are included as reductions of income tax expense in the years in which the credits are used.

## Marketable Investment Securities

Marketable investment securities include:

| | 1978 | 1977 |
|---|---|---|
| Equity securities, at cost . . . . . . | $30,360,863 | $34,193,635 |
| Less valuation allowance charged against shareowners' equity. | (11,346,886) | (14,266,420) |
| Equity securities, at market . . . | $19,014,027 | $19,927,215 |
| Bonds and notes, at cost . . . . . . | 852,712 | 8,514,870 |
| | $19,866,739 | $28,442,085 |

The portfolio of equity securities included gross unrealized gains and losses of $358,994 and $11,705,830, respectively at December 30, 1978 Net realized gains (losses) included in earnings amounted to $(4,006,860) and $60,936 in 1978 and, 1977, respectively. The valuation allowance charged against shareowners' equity increased $5,614,988 during 1977 compared to the previous year and decreased $2,919,584 during 1978 with $2,116,618 charged against earnings

## Unconsolidated Companies

Investments in and advances to unconsolidated companies at December 30, 1978 include:

| | |
|---|---|
| Amusement park joint ventures, at cost plus share of undistributed earnings since acquisition | $44,051,336 |
| Other partially-owned affiliated companies, at cost plus share of undistributed earnings since acquisition | 1,234,581 |
| | $45,285,917 |

The Company has a 50% equity interest in joint ventures which are engaged in the operation of amusement parks. The Company's net earnings include the net earnings (loss) from amusement parks in the amount of $(101,581) for 1978 and $501,512 for 1977.

## Debt Obligations

Long-term debt at December 30, 1978 included:

| | |
|---|---|
| 9⅞% notes maturing in 1983 | $ 50,000,000 |
| 9% sinking fund debentures maturing in 1995; with annual payments of $2,500,000 required from 1979 through 1995 | 35 823,000 |
| 8.70% sinking fund debentures maturing in 1998, with annual payments of $3,000,000 required from 1979 through 1998 | 56,901,000 |
| 8½% sinking fund debentures maturing in 2001, with annual payments of $2,500,000 required from 1982 through 2001 | 50,000,000 |
| 4½% to 5¾% secured notes; annual payments due in varying amounts through 1993 (debt of real estate subsidiary) | 22,514,000 |
| 5¼% to 12% notes; annual payments due in varying amounts through 1996 | 12,350,000 |
| | $227,588,000 |
| Less amount due within one year | 3,882,000 |
| | $223,706,000 |

Under certain of the loan agreements, payments of cash dividends are limited. Under the most limiting agreement, accumulated earnings were unrestricted in the amount of $182,000,000 at December 30, 1978.

## Leases

The 1977 financial statements have been restated to retroactively adopt Statement of Financial Accounting Standards No. 13 for leases entered into prior to January 1, 1977. Leases entered into during 1977 were previously reported as capital leases or operating leases in accordance with this pronouncement. The application of this statement reduced 1978 net earnings by $691,124 (5¢ per share) and 1977 net earnings by $649,811 (5¢ per share).

The Company operates principally in leased premises. Lease terms generally range from ten to twenty-five years with options of renewal for additional periods. Options provide in some cases for reduced rentals and/or the right to purchase. Certain of the leases provide for contingent rental based upon a percent of sales.

Rent expense (under operating leases) for 1978 and 1977 consists of:

| | 1978 | 1977 |
|---|---|---|
| Minimum rentals, net of minor sublease rentals | $ 91,064,692 | $ 81,378,538 |
| Contingent rentals | 8,720,144 | 6,984,803 |
| Total | $ 99,784 836 | $ 88,363,341 |

Assets recorded under capital leases include:

| | 1978 | 1977 |
|---|---|---|
| Distribution and manufacturing facilities | $ 96,577,357 | $ 96,577,357 |
| Store facilities | 36,697,126 | 24,896,052 |
| Less accumulated amortization | (32,766,704) | (28,930,062) |
| | $100,507,779 | $ 92,543,347 |

Minimum annual rentals, net of subleased rentals which are minor in amount, for the five years subsequent to 1978 and in the aggregate are as follows:

| | Capital Leases | Operating Leases |
|---|---|---|
| 1979 | $ 12,560,887 | $ 90,957,236 |
| 1980 | 12,611,781 | 87,511,100 |
| 1981 | 12,683,153 | 84,734,226 |
| 1982 | 12 681,388 | 82,093,003 |
| 1983 | 12,679,694 | 80,276,417 |
| 1984 and thereafter | 202 506,488 | 847,400,784 |
| | $265 723,391 | $1,272,972,768 |
| Less estimated executory costs included in capital leases | 8 691,848 | |
| Net minimum lease payments under capital leases | $256 831,543 | |
| Less amount representing interest | 148,969 708 | |
| Present value of net minimum lease payments under capital leases | $107 861,835 | |

## Common Stock

Changes in common stock during 1977 and 1978 were as follows:

| | Issued | | Treasury | |
|---|---|---|---|---|
| | Shares | Amount | Shares | Amount |
| Balance, Jan 1, 1977 | 13,763,206 | $88,921,835 | 256,673 | $8,761,434 |
| Exercise of options | 88,920 | 1,739,211 | | |
| Acquired | | | 33,554 | 896,657 |
| Balance, Dec 31, 1977 | 13,852,125 | $90,661,044 | 290,227 | $9,658,091 |
| Exercise of options | 68,927 | 1,236,757 | | |
| Balance, Dec 30, 1978 | 13,921,053 | $91,897,801 | 290,227 | $9,658,091 |

On January 19, 1979, the Board of Directors voted to recommend to the shareowners at the 1979 Annual Meeting that the Company's Articles of Incorporation be amended to increase the authorized number of common shares to 50,000,000 with a par value of $1 per share. If the shareowners approve this proposed Amendment, a distribution in the nature of a two-for-one stock split to common shareowners will be made and the number of shares of common stock reserved for stock options will be adjusted accordingly.

## Preferred Stock

The Company has authorized 750,000 shares of voting cumulative preferred stock. The stock has a par value of $50 per share and is issuable in series. None is outstanding at December 30, 1978.

## Stock Option Plans

At December 30, 1978, options were outstanding to purchase 542,902 shares of common stock under the 1965, 1969 and 1976 Stock Option Plans (of which options on 328,309 shares were exercisable at that date) at prices ranging from $15.56 to $33.06 a share. Each option outstanding was granted at an option price equal to the fair market value of the stock at the date of grant. No further options may be granted under the 1965 Plan. Options may be granted under the 1969 and 1976 Plans until 1979 and 1986, respectively. At December 30, 1978, shares of common stock available for future options under the 1969 and 1976 Plans amounted to 2,386 shares and 180,854 shares respectively.

Changes during 1978 in options outstanding under the Stock Option Plans of the Company were as follows:

| | Shares Subject To Option | Option Price Range Per Share |
|---|---|---|
| Outstanding December 31, 1977 | 591,100 | $15.56 - $26.13 |
| Granted | 61,500 | $27.00 - $33.06 |
| Exercised | (68,927) | $15.56 - $25.69 |
| Cancelled or expired | (40,771) | $15.56 - $25.69 |
| Outstanding December 30, 1978 | 542,902 | $15.56 - $33.06 |

See Common Stock note regarding proposed stock split.

## Pension Plans

The Company has three noncontributory retirement plans for eligible employees, two of which have historically been funded. The third retirement plan, which was previously unfunded, is being funded over a period of forty years. The Company also contributes to multi-employer plans jointly administered by management and union representatives.

The actuarially computed value of vested benefits for the Company administered plans as of December 30, 1978 exceeded the total of the pension funds and balance sheet accruals by approximately $62,670,000. Past service costs of the Company's plans are amortized over forty years.

The total pension expense for all plans for 1978 and 1977 was $59,082,048 and $48,530,591, respectively.

## Taxes Based On Income

The provision for taxes based on income consists of:

| | 1978 | 1977 |
|---|---|---|
| Federal | | |
| Current | $47,616,000 | $27,669,000 |
| Deferred | 9,739,000 | 9,333,000 |
| | $57,355,000 | $37,002,000 |
| State and Local | | |
| Current | 11,305,321 | 9,646,796 |
| Total | $68,660,321 | $46,648,796 |

The provision for taxes based on income is lower than the normal statutory corporate tax rate principally due to investment tax credits which reduced the tax provision by $9,914,000 in 1978 and $8,217,000 in 1977.

## Litigation

There are pending against the Company various claims and lawsuits arising in the normal course of business including, as of December 30, 1978, suits charging violations of certain antitrust and civil rights laws. Some of these suits purport or have been determined to be class actions and/or seek damages in very large amounts. Any damages that may be awarded in antitrust cases will be automatically trebled.

Sixteen antitrust suits alleging, among other things, price-fixing in the purchase and sale of meat, have been consolidated for pretrial and discovery purposes in the United States District Court in Dallas. On December 27, 1977, the Court entered a judgment dismissing nine of these suits which had been filed in 1975 and 1976. Appeals have been filed in eight of the dismissed suits. No appeal was filed in the ninth suit but a similar suit was filed in California under state antitrust statutes. The Company's motions have been sustained disposing of the case, although the final judgment in the Company's favor has not been entered in the record as yet. The complaints in the remaining seven suits, which were filed in 1977, include certain allegations not contained in the earlier filed suits. Since discovery has been very limited, and since each of the suits, if tried at all, may go to a jury, the Company cannot predict their ultimate outcome. The Company believes, however, that it has substantial defenses available and should prevail in all.

Although the amount of liability at December 30, 1978 with respect to all claims and lawsuits cannot be ascertained, the Company is of the opinion that any resulting liability will not have a material effect upon the Company's financial position.

## Segments of Business

The Company's segments of business information for 1978 and 1977 are included on page 15.

## Quarterly Financial Data (Unaudited)

Quarterly sales, merchandise costs, net earnings and net earnings per share of common stock for 1978 and 1977 are presented on page 14.

## Replacement Cost (Unaudited)

As required by the Securities and Exchange Commission, current replacement cost information for certain assets and certain costs and expenses are to be disclosed in the Company's Form 10-K filed with the Commission.

The current replacement cost of the Company's affected inventories and productive capacity and the amount of the associated merchandise costs and depreciation expense calculated using replacement costs are generally higher than the comparable historical cost amounts shown in the financial statements.

# Report of Certified Public Accountants

To the Shareowners and Board of Directors
The Kroger Co.

We have examined the consolidated balance sheets of The Kroger Co. and Consolidated Subsidiary Companies as of December 30, 1978 and December 31, 1977, and the related consolidated statements of earnings, accumulated earnings and changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of The Kroger Co. and Consolidated Subsidiary Companies at December 30, 1978 and December 31, 1977, and the consolidated results of their operations and changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in the method of accounting for leases as described in Notes to Consolidated Financial Statements.

Coopers & Lybrand
3800 Carew Tower
Cincinnati, Ohio 45202
February 16, 1979

Coopers & Lybrand

# Five Year Summary

| Operations (thousands of dollars, except per share figures) | | 1978 | 1977(b) | 1976(a)(b) | 1975(b) | 1974(b) |
|---|---|---|---|---|---|---|
| Sales | $ | **7,828,071** | 6,747,583 | 6,182,991 | 5,421,296 | 4,893,384 |
| Costs and Expenses | $ | **7,674,815** | 6,640,881 | 6,097,816 | 5,362,417 | 4,811,772 |
| Earnings before Taxes Based on Income | $ | **153,256** | 106,672 | 85,175 | 58,879 | 81,612 |
| Taxes Based on Income | $ | **68,660** | 46,649 | 37,250 | 24,822 | 36,729 |
| Net Earnings | $ | **84,596** | 60,023 | 47,925 | 34,057 | 44,883 |
| Dividends | $ | **24,219** | 20,557 | 18,577 | 18,298 | 18,088 |
| Per Share | | | | | | |
| Net Earnings | $ | **6.22** | 4.44 | 3.55 | 2.52 | 3.33 |
| Dividends | $ | **1.78** | 1.52 | 1.38 | 1.36 | 1.34½ |

| Balance Sheet Statistics (thousands of dollars, except per share figures) | | 1978 | 1977(b) | 1976(a)(b) | 1975(b) | 1974(b) |
|---|---|---|---|---|---|---|
| Inventories | $ | **697,327** | 623,645 | 556,347 | 500,110 | 490,640 |
| Working Capital | $ | **289,267** | 294,057 | 298,528 | 216,524 | 158,418 |
| Property, Plant and Equipment, net | $ | **621,292** | 570,989 | 544,472 | 534,979 | 526,439 |
| Total Assets | $ | **1,653,029** | 1,528,721 | 1,445,302 | 1,302,049 | 1,269,045 |
| Long-Term Debt | $ | **223,738** | 238,892 | 259,561 | 213,085 | 164,498 |
| Shareowners' Equity | $ | **554,507** | 489,972 | 455,273 | 423,721 | 418,477 |
| Per Share of Common | $ | **40.68** | 36.13 | 33.71 | 31.41 | 31.03 |

| Other Statistics (dollars and shares in thousands) | | 1978 | 1977(b) | 1976(a)(b) | 1975(b) | 1974(b) |
|---|---|---|---|---|---|---|
| Capital Expenditures | $ | **114,504** | 96,417 | 81,906 | 70,161 | 116,720 |
| Depreciation and Amortization | $ | **65,179** | 61,394 | 57,294 | 55,251 | 50,021 |
| Rent | $ | **99,785** | 88,363 | 82,611 | 74,632 | 67,341 |
| Interest Expense | $ | **29,983** | 30,626 | 27,713 | 25,438 | 23,384 |
| Dividend and Interest Income | $ | **12,097** | 8,467 | 7,327 | 5,000 | 5,025 |
| Common Shares Outstanding | | **13,631** | 13,562 | 13,507 | 13,489 | 13,487 |
| Number of Shareowners | | **37,413** | 40,123 | 42,508 | 44,941 | 45,766 |

| Retail Facilities (areas in thousands of square feet) | 1978 | 1977(b) | 1976(a)(b) | 1975(b) | 1974(b) |
|---|---|---|---|---|---|
| Food Stores | | | | | |
| Opened | **104** | 98 | 90 | 71 | 83 |
| Remodeled | **58** | 35 | 33 | 40 | 84 |
| Closed | **90** | 83 | 137 | 92 | 127 |
| Stores — End of Year | **1,202** | 1,188 | 1,173 | 1,220 | 1,241 |
| Total Area | **30,673** | 28,642 | 26,850 | 26,415 | 25,594 |
| Drug Stores | | | | | |
| Opened | **7** | 11 | 20 | 56 | 64 |
| Closed | **48** | 41 | 13 | 27 | 35 |
| Stores — End of Year | **487** | 528 | 558 | 551 | 522 |
| Total Area | **5,891** | 6,108 | 6,399 | 6,234 | 5,683 |

(a) Fifty-three weeks
(b) Restated to reflect the change made in 1978 in accounting for leases

# Directors

**James E. Baker,** *Vice President*
**Philip E. Beekman,** *President Joseph E. Seagram & Sons, Inc*
**William W. Boeschenstein,** *President and Chief Executive Officer, Owens-Corning Fiberglas Corporation*
**Raymond B. Carey, Jr.,** *Chairman of the Board and President, American District Telegraph Company*
**Lyle Everingham,** *President, Chairman of the Board and Chief Executive Officer*
**James P. Herring,** *Former Chairman and President*
**Jackson C. Hinds,** *Chairman of the Board and Chief Executive Officer, Eutex, Inc.*
**Patricia Shontz Longe,** *Professor Business Administration, University of Michigan*
**T. Ballard Morton, Jr.,** *President, Orion Broadcasting, Inc*
**Thomas H. O'Leary,** *President, Missouri Pacific Corporation*
**John D. Ong,** *President and Chief Operating Officer, The B. F. Goodrich Company*
**W. George Pinnell,** *Executive Vice President Indiana University*
**R. Nelson Shaw,** *Former Director and Chairman, Mercantile Stores Company, Inc.*
**Edward D. Smith,** *Hansell, Post, Brandon & Dorsey*
**Morley P. Thompson,** *President, Baldwin-United Corporation*

A copy of the Company's 1978 report to the Securities and Exchange Commission, Form 10-K, is available to shareowners on request by writing Irle R. Hicks, Treasurer, The Kroger Co., 1014 Vine Street, Cincinnati, Ohio 45201

The annual meeting of shareowners will be held at the Corbett Tower, Music Hall, 1243 Elm Street, Cincinnati, Ohio on April 12, 1979 at 10 a.m.

**Transfer Agent and Registrar**

The First National Bank
111 East Fourth Street
Cincinnati, Ohio 45202
Telephone 513-632-4648

New York Stock Exchange Listing — Symbol KR.

# Corporate Officers

**Raymond F. Abaray,** *Vice President*
**James E. Baker,** *Vice President*
**Robert W. Zimmerschweig,** *Vice President*
**John A. Cornett,** *Senior Vice President*
**Lyle Everingham,** *President, Chairman of the Board and Chief Executive Officer*
**Arthur Juergens,** *Vice President*
**William G. Kagler,** *Senior Vice President*
**George W. Keith,** *Vice President President, SupeRx Drug Stores*
**Richard M. Koster,** *Group Vice President*
**George A. Leonard,** *Vice President Secretary and General Counsel*
**William W. Oliver,** *Group Vice President*
**Robert E. Saffron,** *Vice President*
**John L. Strubbe,** *Group Vice President*
**Charles L. Thomas,** *Group Vice President*
**Irle R. Hicks,** *Treasurer*

# Operating and Staff Vice Presidents

## Corporate Staff

Stuart M. Berman, *Planning*
Carl W. Brieske, *Tax Counsel*
Robert L. Cottrell, *Procurement and Trade Relations*
Paul A. Gibson, *Personnel*
Don A. Hirsch, *Labor Relations*
Jack G. Hudson, *Controller*
Lorrence T. Kellar, *Capital Management*
C. Manly Molpus, *Corporate Affairs*

## Kroger Food Stores

### Headquarters Staff

Rudolph G. Bublitz, *Advertising*
Bobbie L. Criswell, *Distribution Operations*
Donald F. Dufek, *Store Operation Services*
F. Leland Davis, *Consumer Research*
Richard W. Goff, *Meat Plant Operations*
J. Wayne Harris, *Produce Merchandising*
Dean A. Hicks, *Marketing Administration*
George L. Irwin, *Delicatessens/Bakeries*
Thaddeus J. Kaczmarowski, *Facility Engineering*
Adrian L. Vannice, *Grocery Merchandising*
Walter W. White, *Distribution Administration*

### Marketing Areas

Richard L. Bere, *Columbus*
Newton W. Briggs, *Dallas*
David A. Burt, *Michigan*
Walter R. Dryden, *Southland*
Theodore Engel, *Central*
Robert G. Everingham, *Houston*
Joel E. Groenisen, *Louisville*
Robert L. Hayden, *Market Basket*
James A. LeRoy, *Delta*
Robert E. Saffron, *Cincinnati*
Nerville A. Sawall, *Gateway*
Richard D. Schill, *Carolinas*
Edwin A. Sieveking, *Mid-Atlantic*
Gerald L. Wolken, *Erie*

## Kroger Manufacturing

Ferd M. Kisro, *Administration*
George M. Laughlin, *Grocery Products Division*
Norbert J. Panko, *Controller*
William R. Pugh, *Baked Foods Division*
Ronald R. Rice, *Dairy Foods Division*
William Harold Wall, *Poultry & Egg Division*
Robert M. Williams, *Research and Developmental Engineering*

## SupeRx Drug Stores

### Headquarters Staff

N. Ronald Adams, *Finance*
Frank Corella, *Sales*
Henry J. Fitzgerald, *Optical*
Albert G. Harsnett, *Advertising*
Brian Holt, *Marketing*
William J. Howe, *Administration Services*
William J. Johnson, *Business Planning*

### Retail Operations

Clarence H. Archer, *Southern Region*
Ronald R. Baumgartn, *North East Region*
Dennis O. Curran, *Florida Region*
Gary E. Hendren, *North Central Region*
Gordon P. Saue, *New Stores*

The Kroger Co.
1014 Vine Street
Cincinnati, Ohio 45201
(513) 762-4000